

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0208

**Adjusted Gross Income Tax
For Tax Years 1992 through 1994**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax—Throwback Sales

Authority: Wisconsin Department of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); IC 6-3-1-25; IC 6-3-2-2

Taxpayer protests the imposition of income tax on sales to foreign countries.

II. Adjusted Gross Income Tax—Foreign Source Dividend Expense

Authority: IC 6-3-2-12

Taxpayer protests a fifteen percent (15%) reduction of the foreign dividend deduction expenses attributed to the earning of dividends.

III. Adjusted Gross Income Tax—Foreign Source Dividend Deduction

Authority: IC 6-3-2-12

Taxpayer protests the add-back of foreign source dividends.

IV. Tax Administration—Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer manufactures and sells pharmaceuticals, medical equipment, and agricultural and industrial chemicals. Taxpayer has operations in the United States and several foreign countries. As the result of an audit conducted for the tax years 1992 to 1994, the Department issued proposed income tax assessments to taxpayer. Taxpayer protests these proposed assessments on several grounds. Further facts will be provided as necessary.

I. Adjusted Gross Income Tax—Throwback Sales

DISCUSSION

Taxpayer protests the inclusion of throwback sales to foreign countries in income tax assessments. The Department assessed these sales on the grounds that taxpayer was not taxed in those countries, and the income was therefore properly taxable in Indiana. Taxpayer protests that it was taxable, if not actually taxed, in those countries. The Department added the foreign sales back in order to adjust the sales factor of the apportionment formula, as provided in IC 6-3-2-2(b), which states in relevant part:

Except as provided in subsection (1), if business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, then the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three (3).

IC 6-3-1-25 states:

The term “state” means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

Taxpayer asserts that it is taxable in the foreign countries of the purchasers with regard to the bulk of the throwback sales. IC 6-3-2-2(n) states:

For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:

- (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
- (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact the state does or does not.

The United States Supreme Court's decision in Wisconsin Department of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992), provides guidance for this case. In Wrigley, the Court ruled that the Wrigley chewing gum company was subject to taxation in Wisconsin even though the taxable activity was only 0.00007% (several hundred dollars in absolute terms) of Wrigley's total activity in the state. Wrigley, at 235. The Court also explained:

Accordingly, whether in-state activity other than "solicitation of orders" is sufficiently *de minimis* to avoid loss of the tax immunity conferred by § 381 depends upon whether that activity establishes a nontrivial additional connection with the taxing State.

Wrigley, at 232

Also of relevance is the Court's explanation that Wrigley's activities would not be considered in isolation, but rather were taken together to determine whether or not the activities were *de minimis*. Wrigley, at 235.

Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the three audit years in: Australia, Belgium, Canada, Denmark, France, Germany, Japan, Mexico, Puerto Rico, Singapore, Taiwan, and the United Kingdom. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit years 1993 and 1994 in Brazil, Columbia, and Ireland. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit years 1992 and 1994 in Italy. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit years 1992 and 1993 in Austria. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit year 1992 in Spain, Sweden, and Switzerland. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit year 1993 in Venezuela. Taxpayer has provided documentation establishing that it was involved in non-solicitation activities and/or maintained inventory for the audit year 1994 in Guatemala.

This documentation establishes that taxpayer had nontrivial contacts with those countries in those years, under the test provided in Wrigley. Therefore, taxpayer was doing business in those countries for those countries for those years, and so those countries had jurisdiction to tax taxpayer for those years, as provided in IC 6-3-2-2(n). Under IC 6-3-2-2(e)(2)(B), the throwback sales are not assigned to Indiana.

FINDING

Taxpayer's protest is sustained to the extent that it was taxable in a given country for a given year. Taxpayer's protest is denied to the extent that it was not taxable in a given country for a given year.

II. Adjusted Gross Income Tax—Foreign Source Dividend Expense

DISCUSSION

In calculating its Indiana tax liabilities, taxpayer, pursuant to IC 6-3-2-12, deducted foreign source dividend income from its Indiana adjusted gross income. The Department, however, disagreed with taxpayer's calculations. Re-calculation by the Department resulted in an increase in taxpayer's Indiana adjusted gross income and tax. Proposed assessments of Indiana adjusted gross income tax followed. The Department added back foreign source dividends.

Taxpayer, in response, directs the Department's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year;
multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) percent ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

This statutory language is cogent and clear. IC § 6-3-2-12 authorizes pro rata deductions (based on the percentage ownership of the payor by the payee) of certain foreign source dividend income. In this instance, taxpayer has followed the statutory prescriptions in calculating its foreign source dividend deductions.

FINDING

Taxpayer's protest is sustained.

III. Adjusted Gross Income Tax—Foreign Source Dividend Deduction

DISCUSSION

In calculating its Indiana tax liabilities, taxpayer, pursuant to IC 6-3-2-12, deducted foreign source dividend income from its Indiana adjusted gross income. The Department, however, disagreed with taxpayer's calculations. Re-calculation by the Department resulted in an increase

in taxpayer's Indiana adjusted gross income and tax. Proposed assessments of Indiana adjusted gross income tax followed. The Department added back foreign source dividends where it did not believe that the companies involved were sufficiently related.

Taxpayer, in response, directs the Department's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year;
multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) percent ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

The Department added these deductions back to taxpayer's income because the companies did not satisfy the requirements of IC 6-3-2-12(b). Taxpayer has not provided sufficient documentation to rebut the Department's position.

FINDING

Taxpayer's protest is denied.

IV. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. Taxpayer requests that all penalties be waived as it has acted in good faith at all times, and any remaining assessments are not the result of any willful disregard of Indiana's tax laws, or negligence on the part of taxpayer. Negligence is defined by 45 IAC 15-11-2(b), which states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the

Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Taxpayer was able to provide sufficient documentation to be sustained for the majority of the throwback sales in Issue I and was sustained on Issue II. While taxpayer was denied on Issue III, this was a new issue for the audit period. Therefore, taxpayer has demonstrated that it was not negligent in filing its returns.

FINDING

Taxpayer's protest is sustained.

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